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ABSTRACT

Franchise fees are a tax imposed on a private entity to compensate a municipality for use of a public property for private gain. The Telecommunications Act of 1996 grants municipalities the right to assess a 5% franchise fee to both cable companies and competitors of cable companies, such as operators of open video systems. The Minnesota State Department of Public Service surveyed all municipalities, telephone companies, telecommunication carriers, investor-owned natural gas utilities, investor-owned electric utilities, and cable communications companies in the state of Minnesota to collect data on franchise fee collection and use. The survey identified 209 municipalities that access franchise fees on cable communication companies. Franchise fee collection is the most prevalent with cable companies, which are also required by state law to provide access channels for public, educational, and government (PEG) access. The four technologies capable of delivering subscription video services are standard cable television, open video systems, wireless cable, and direct broadcast satellite. Only standard cable television is both subject to a franchise fee on all gross revenues and is also a technology which is fully compatible with local PEG access requirements. The government must regulate its fee and requirement policy to prevent increased consumer subscription costs and loss of competition among competing technologies, and to maintain current franchise fee revenue and PEG access. The document includes the following sections: (1) Background on Franchise Fees and Public, Educational and Government Fees; (2) Franchise Fees (amount collected, use of franchise fees); (3) PEG Access (PEG programming and viewership); (4) Video Technologies, Franchise Fees, and PEG Access; (5) Recommendations for a State Policy Regarding Franchise Fees and Related Compensation; and (6) Conclusion. (Author/SWC)

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MINNESOTA DEPARTMENT OF PUBLIC SERVICE

REPORT TO THE MINNESOTA LEGISLATURE ON FRANCHISE FEES AND PUBLIC, EDUCATIONAL AND GOVERNMENT (PEG) ACCESS

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BACKGROUND ON FRANCHISE FEES AND PUBLIC, EDUCATIONAL AND GOVERNMENT FEES

FRANCHISE FEES

In theory, franchise fees are a tax imposed on a private entity to compensate a municipality for use of a public property for private gain. The public properties being used by utilities and cable communications companies are the rights-of-ways under city streets, the easements in private properties, ditches along roads and highways, etc. When a utility or cable communications company places a trench in the street of a municipality, current law and/or contractual agreements require that the property must be restored to the same or better condition prior to the construction. Franchise fee revenue is not used for such construction. However, some municipalities argue that there are future costs associated with cutting a street that are incurred by a municipality. Thus, the argument is that franchise fee revenues collected today not only compensate the municipality for use of a public property, but also compensate the municipality for costs that will be incurred in the future.

Being subject to a franchise fee does provide some benefits to the utility and cable communications companies. The terms of the franchise give authorization to the companies to use the rights-of-ways of municipalities. Although the companies are required to obtain permits for construction and repair damage, they cannot unreasonably be denied access to the rights of way. Since the municipality is receiving compensation, it cannot deny the rights granted to the company. Although municipalities have experience in managing their rights-of-way, they have rarely been required to address the desires of multiple providers to use rights-of-way for duplicate facilities. Competition in the cable and telephone markets will force many municipalities to rethink how rights-of-way are managed.

Franchise fees are limited to 5 percent by federal law for cable communications companies. There is no federal law restricting the franchise fee for electric and natural gas utilities. With the Telecommunications Act of 1996, municipalities will have the continued option of assessing a franchise fee of up to 5 percent on cable companies. Municipalities also are permitted to assess a franchise fee of up to 5 percent on competitors of cable companies, such as operators of open video systems. It is too early to understand precisely how open video systems will operate and what services will be available through such systems. The FCC is to conduct a rulemaking which should clarify these issues.

In response to the requirement in the 1995 legislation and in preparation for this report to the Legislature, the Department prepared a survey questionnaire to obtain necessary background information.

The questions in the survey pertaining to franchise fees were directed to all municipalities, telephone companies, telecommunications carriers, investor-owned natural gas utilities, investor-owned electric utilities, and cable communications companies in the state of Minnesota. The number of questionnaires sent to each type of entity and the number of responses received from each type of entity is provided in Attachment 1.

The survey identified 209 municipalities that assess franchise fees on cable communications companies. The survey also reflected that there are five natural gas companies that pay franchise fees to 11 communities, and 14 electric utilities that pay franchise fees to 19 communities in which they serve.[1] The telephone companies responding to the survey indicated that they do not pay franchise fees in any municipality. Although not all municipalities and companies responded to the survey, the application of franchise fees is clearly the most prevalent with cable service. In addition to the payment of franchise fees, cable communications companies are also required by state law to provide access channels in the municipalities they serve for public, educational and government (PEG) access. Further, many municipalities receive other compensation from cable communications companies in return for being granted their cable franchise.

AMOUNT OF FRANCHISE FEES COLLECTED

A. ELECTRIC UTILITIES

In 1994, the franchise fees assessed on electric utilities ranged from $400 to $11,252,099. Franchise fees are generally based on a percentage of gross revenue, although there are a couple of municipalities that assess a flat fee. When based on gross revenue, the fees range from one percent in Sauk Centre to eight percent in St. Paul. Total franchise fees reportedly paid during the year 1994 by the five investor-owned electric utilities responding to the survey was $27,066,845. The municipalities that assess franchise fees, the electric utilities paying franchise fees, and the amount paid during 1994 are presented in the table below.[2]

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[1] Nine of the 14 electric utilities are municipally owned and five of the 14 electric utilities are investor owned.

[2] There were no municipalities with a population less than 1000, or between 5,000 and 10,000 that responded to the survey and assess a franchise fee on electric utilities.

Table 1

Municipalities with a Population of at least 1,000 but less than 5,000

Municipality	Utility	Franchise Fee Paid
Blue Earth	Blue Earth Light & Water	Not Provided
Mora	City of Mora	108,000.00
Newport	Northern States Power	400.00
Sauk Centre	Sauk Centre Public Utilities	40,000.00
St. Charles	St. Charles Light & Water	60,261.00

Municipalities with a Population of at least 10,000 but less than 20,000

Municipality	Utility	Franchise Fee Paid
Albert Lea	Freeborn-Mower	15,121.00
Albert Lea	Interstate Power Company	942,234.00
Marshall	Marshall Public Utilities	Not Provided
Mounds View	Northern States Power	224,134.00

Municipalities with a Population of at least 20,000 but less than 50,000

Municipality	Utility	Franchise Fee Paid
Apple Valley	Dakota Electric	Not Provided
Moorhead	Moorhead	245,195.00
South St. Paul	Northern States Power	416,807.00
White Bear Lake	Northern States Power	136,640.00
Winona	Northern States Power	573,426.00

Municipalities with a Population of at least 50,000 but less than 100,000

Municipality	Utility	Franchise Fee Paid
Coon Rapids	Northern States Power	334,954.00
Coon Rapids	Anoka Municipal Utilities	507,189.00
Duluth	Minnesota Power	700,000.00
Rochester	Peoples Coop	109,775.00
St. Cloud	Northern States Power	11,919.00
St. Cloud	Stearns Electric	859,539.00

Municipalities with a Population of at least 100,000

Municipality	Utility	Franchise Fee Paid
Minneapolis	Northern States Power	11,252,099.00
St. Paul	Northern States Power	10,529,152.00

NOTE: Fees paid to St. Paul are listed as reported by Northern States Power because St. Paul did not distinguish between gas and electric fees received.

B. NATURAL GAS UTILITIES

The franchise fees assessed on gas utilities, as reported by municipalities for 1994, ranged from $34,581 to $5,548,106. Where responses have been received, the fees are based on a percentage of gross revenue. The range of percentages is from

three percent in St. Cloud to eight percent in St. Paul. Total franchise fees paid to municipalities as reported by gas utilities for 1994 is $9,854,907.[3] Unfortunately, over half of the responding municipalities did not indicate the amount of franchise fees assessed on natural gas utilities. The municipalities responding to the survey that assess franchise fees on natural gas utilities, the utility assessed, and the amount paid during 1994 are provided in the table below.[4]

Table 2

Municipalities with a Population of at least 1,000 but less than 5,000

Municipality	Utility	Franchise Fee Paid
Blooming Prairie	Peoples	Not Provided
Lake City	Northern States Power	34,581.00
Newport	Northern States Power	Not Provided

Municipalities with a Population of at least 10,000 but less than 20,000

Municipality	Utility	Franchise Fee Paid
Albert Lea	Interstate Power Company	Not Provided
Lino Lakes	Circle Pines Utilities	Not Provided
Mounds View	Northern States Power	Not Provided

Municipalities with a Population of at least 20,000 but less than 50,000

Municipality	Utility	Franchise Fee Paid
Moorhead	Northern States Power	Not Provided

Municipalities with a Population of at least 50,000 but less than 100,000

Municipality	Utility	Franchise Fee Paid
Coon Rapids	Minnegasco	510,876.00
St. Cloud	Northern States Power	261,668.00

Municipalities with a Population of at least 100,000

Municipality	Utility	Franchise Fee Paid
Minneapolis	Minnegasco	5,548,106.00
St. Paul	Northern States Power	3,499,676.00

NOTE: Fees paid to St. Paul are listed as reported by Northern States Power because St. Paul did not distinguish between gas and electric fees received.

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[3] St. Paul did not separate its gas and electric revenues from NSP, therefore, the Department used NSP's reported fees as a proxy for St. Paul's natural gas franchise fee revenue from NSP.

[4] There were no municipalities with a population with less than 1,000 or between 5,000 and 10,000 that responded to the survey and assess a franchise fee on natural gas utilities.

C. *Cable Communications Companies*

The franchise fees assessed on cable communications companies, as reported by municipalities for 1994, ranged from $70 to $1,287,663. Total franchise fees reportedly paid to municipalities by cable communications companies for 1994 is $8,779,215. Where responses have been received, the fees are generally based on a percentage of gross revenue. The range of percentages is from one percent to five percent. There are numerous municipalities that assess a franchise fee at three percent of gross revenue. The range of fees based on the population of the municipality is provided in Table 3 below.

Table 3

Population	Total # of Municipalities Responding	Receive Franchise Fees	Range of Fees	Receive Other Compensation
Under 1,000	159	59	$70 to $5,241	
1,000 to 5,000	107	81	$245 to $19,043	3 participate in NCSCC*
5,000 to 10,000	21	20	$100 to $51,317	2 participate in NCSCC*
10,000 to 20,000	22	21	$9,800 to $325,192	1 receives $20,000 in Capital Equip.
20,000 to 50,000	19	17	$16,844 to $206,261	1 participates in NCSCC*, 1 participates in NSCCC**
50,000 to 100,000	9	9	$122,191 to $343,887	1 participates in NCSCC*
Over 100,000	2	2	$1,037,495 to $1,287,683	
TOTALS	339	209	$8,779,215	

* The eight municipalities forming the North Central Suburban Cable Commission (NCSCC) receive $265,000 in capital equipment from Meredith Cable.

** The nine communities forming the Northwest Suburbs Cable Communications Commission (NSCCC) receive PEG channels valued at $364,039.

Many metropolitan area municipalities and a few outstate municipalities that are served by the same cable communications company have joined to form cable communications commissions. Cable communications commissions operate under joint powers agreements pursuant to Chapter 238 of the Minnesota Statutes. These commissions enforce and administer the cable communications franchise agreements and approve the rates charged to cable customers. Thus, a single entity is created for the administration of the cable franchises on behalf of the participating municipalities. Since all communities participating in a cable communications commission operate under a single agreement with the cable communications company, the same fees are assessed by each of the participating communities. In

each of the cable commissions that was identified by the survey, the franchise fee is five percent of gross revenues. A list of the cable communications commissions identified by the Department's survey is provided in Attachment 2.

In addition to the fees paid to municipalities in the form of franchise fees, 35 municipalities responding to the Department's survey indicated that they receive franchise related compensation from the cable communications company serving their area.[5] The primary form of franchise related compensation is the provision of equipment, facilities, personnel and access channels to enable PEG programming. As will be explained, there are legal requirements applicable to cable communications companies for the provision of PEG access. Other forms of compensation include institutional networks for use by the municipality, scholarship funds, promotional advertising, cable facilities extended to municipal buildings, rent subsidies and free cable service.

The estimated value of other compensation for a single municipality is as high as $11.7 million, as reported by Paragon Cable for the City of Minneapolis. Over $10.7 million of this amount is the estimated value of access channel bandwidth as reported by Paragon Cable. There are currently 30 channels provided to the City of Minneapolis by Paragon Cable. For the City of St. Paul, Continental Cable estimates the value of other compensation provided to the city in 1995, at $2,133,255. Over half of this amount is attributable to five access channels provided to the city.

USES OF FRANCHISE FEES

Each municipality that assesses franchise fees on natural gas utilities states that the fees are placed in the general fund of the municipality. For electric utilities, ten municipalities reported that the franchise fees received were dedicated to the municipality's general fund. One municipality reported that franchise fee revenue from the electric utility is dedicated to street improvements; another indicated that franchise fee revenue is dedicated for rights of way; a third indicated that franchise fee revenue is used to offset the cost of regulation and the impact on public property, such as damage to streets; and a fourth indicated the fees are used for reimbursement for the relocation of power lines. Five municipalities had no response.

The franchise fees collected from cable communications companies have multiple uses by the municipalities. Most of the municipalities report that franchise fee revenue does not have a dedicated use, and is placed in the general fund. There are also a significant number of municipalities that state that franchise fees are dedicated for cable related activities. Such activities may include equipment for PEG

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[5] Minn. Stat. Ch. 238 establishes minimum requirements for PEG access based on three categories of cable television systems.

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access and labor costs associated with PEG programming. Another use of franchise fees is to support a cable communications commission. Each municipality that participates in a cable communications commission must provide part of the financial support required of the commission. There are a few communities that support a cable commission, without any proceeds remaining for use by the municipality. Other uses of funds include community projects, the parks & recreation department, and costs associated with rights-of-way, such as street repair. A more detailed breakdown of the uses of funds is provided below in Table 4.

Table 4

	Use of Funds						
Population	General Fund	Community Projects	PEG Access Equipment	Cable Related Activities	Cable Commission	Park & Rec.	Rights of Way
Under 1,000	24	3	3	3	2	5	-
1,000 to 5,000	28	-	4	20	9	2	2
5,000 to 10,000	1	-	2	9	4	-	-
10,000 to 20,000	5	-	2	10	2	-	1
20,000 to 50,000	2	-	2	8	2	-	2
50,000 to 100,000	2	-	-	6	-	-	1
Over 100,000	2	-	-	-	-	-	-

PEG ACCESS

In addition to the 5 percent franchise fees, many municipalities receive access channels from cable communications companies. These channels are generally used for public, educational and government (PEG) access. The number of channels range from one channel in smaller communities to 30 channels in the City of Minneapolis. PEG access enables citizens, schools and government to broadcast their programming to the subscribers of the local cable system. Minnesota Statute § 238.084, subd. 1 requires that PEG access be available on a first-come, first-served, nondiscriminatory basis. Unless the material is obscene and violates federal regulations, the cable communications company will broadcast the program.

In smaller communities the PEG access channel may be used for simply displaying a calendar of local activities. In other communities, the PEG access channel(s) may present city council meetings, high school sporting events, non-profit group meetings, and specific interest group discussions.

Under current Minnesota law, there are three categories of cable television systems, each of which has statutory minimum requirements for PEG access. They are:

1. Class A Systems: non-metro systems serving fewer than 1,000 customers in a franchise area with a population of fewer than 4,000 persons. Minnesota law requires a minimum of one PEG access channel primarily for serving government and educational uses. There are approximately 250 systems of this size in the state.

PEG access in Class A systems is usually limited to institutional uses which often carry character-generated programming to air schedules of events and other announcements. They may also carry audio or audio/video cablecasts of public meetings.

Initial costs for PEG access equipment, as well as ongoing financial support, is usually paid by the cable operator, then passed on to subscribers through monthly rates. There is generally sufficient PEG access channel time available on Class A systems, although some small communities have opted to forego PEG access programming.

2. Class B Systems: non-metro systems serving fewer than 3,500 customers in a franchise area with a population of fewer than 15,000 persons. Minnesota law requires a minimum of one PEG channel for public, government and educational use. There are approximately 60 systems of this size in the state.

For the most part, content of PEG access programming in Class B systems is similar to that in Class A systems. However, in Class B systems the public has the ability to provide programs for PEG access channels.

Initial costs for PEG access equipment, as well as ongoing financial support, is usually paid by the cable operator, then passed on to customers through monthly rates. As with smaller systems, there is generally sufficient PEG access time available in Class B systems.

3. Class C Systems: metro systems, as well as non-metro systems, which serve more than 3,500 customers in a franchise area with a population of more than 15,000 persons. Minnesota law requires a minimum of four PEG channels dedicated for specific purposes -- public, educational, government and leased. Class C systems operating in a metro area must also provide a fifth channel for regional programming.

Some Class C systems operating in the metro area offer up to 12 PEG access channels, while Paragon Cable provides 30 channels in Minneapolis. The 30 channels furnished by Paragon Cable to the City of Minneapolis include PEG access as well as channels for the city's internal use. Again, initial costs for PEG access equipment and ongoing financial support is generally paid by the cable operator, then passed on to customers through monthly rates.

PEG programming in Class C systems tends to have greater variety than do smaller systems and is discussed below.

PEG PROGRAMMING

Paragon Cable provides PEG access in the cities of Bloomington, Chaska, Fridley, Jordan, Minneapolis, New Prague, New Ulm, Shakopee, Eden Prairie, Edina, Hopkins, Minnetonka and Richfield. In the cities of Eden Prairie, Edina, Hopkins, Minnetonka and Richfield, 163 organizations use PEG access with 9,375 hours of programming presented on PEG channels in the last year. The following are among the PEG access programs offered through Paragon Cable during November 1995:

- Southwest Community News
- Calvary Temple
- Candidate Forum
- High School Football: Hopkins vs. Richfield
- Eden Prairie Environmental and Waste Management Commission Presentation
- Richfield Cattail Days -- A Community Celebration 1995
- Health Care Crisis
- Journal de France
- Eden Prairie Planning Commission
- Hopkins City Council
- Careers and Youth
- 1995 Minnetonka Safety Camp
- NASA Presents
- Wayzata School Programming
- The Town Without a Name
- Minnetonka High School Band Fall Concert
- The Prism Project: Adult Bible Study
- Twin Cities Sportsman
- Elizabeth Claire Prophet
- Viewpoints in Mid-America

The level of PEG programming varies significantly in non-metro areas. For example, while PEG access in Carlton is available through the neighboring municipality, use is minimal. On the other hand, Moorhead Community Access Television carries Moorhead city council meetings, live sessions of the Minnesota Legislature, candidate debates, 49 hours per week of college level courses through the Mind Extension University, General Education Diploma study courses, music videos, dramatic narratives, non-profit group meetings or seminars, specific interest discussion groups, how-to programs, religious services and religious instructions.

PEG access programming is usually funded by grants, franchise fees and PEG access fees which are paid by cable operators to municipalities and used to purchase equipment. In some cases, revenue is used to directly or indirectly pay staff. Costs incurred by cable companies are figured in total operational costs and then factored into establishing monthly rates paid by consumers.

VIEWERSHIP

Responses to the Department's survey mentioned a few studies on PEG access satisfaction and viewership. They included surveys on behalf of St. Paul and the North Suburban Cable Commission (both conducted by Decision Resources Ltd.), as well as a subscriber survey conducted by Paragon Cable. The studies by Decision Resources Ltd. indicated a high level of satisfaction among those who view and use PEG access. The Paragon survey indicated little viewership of PEG programming among its customers. The Department did not have enough underlying data to assess the reliability of these studies.

Nielson Media Research, a national firm with an extensive background in measuring television viewership, estimates there are 1,412,000 television households in the metro viewing market. The company tracks viewing habits in the market through electronic meters and individual diaries. It measures the number of households viewing a particular channel in specific time periods each day beginning at 7:00 a.m. and ending at 1:00 a.m. The system is designed to register an audience of .1 percent and above. In the Twin Cities market, .1 percent equals 1,412 households. Their system also tracks the cumulative audience for specific channels during the course of each week. Channels with a cumulative weekly audience share of 2.5 percent (35,300 households metro) and above are individually listed; the rest are included in the "all others" category. While there has not been a specific study to determine exact PEG access viewership, metro PEG access channels typically do not appear in either measurement.

VIDEO TECHNOLOGIES, FRANCHISE FEES AND PEG ACCESS

At this time, franchise fees and PEG access requirements apply only to these traditional cable television companies in the video services industry. Other video delivery systems, such as satellite and "wireless" cable systems, either fall outside of a municipality's authority to levy fees, or are not technologically compatible with the provision of PEG access. Open Video Systems may be subject to franchise fees and PEG access requirements under the Federal Telecommunications Act of 1996 depending on the outcome of the rulemaking. The FCC is to complete all actions necessary to prescribe regulations on open video systems by August 8, 1996.

In order to best understand how the issues of PEG access and franchise fees apply to an evolving industry, a review of the technology and delivery of cable television, satellite, wireless cable and open video systems follows.

CABLE TELEVISION

Under Minn. Stat. § 238.02, subd. 3, cable communications systems are defined as "a system which operates the service of receiving and amplifying programs broadcast by one or more television or radio stations and other programs originated by a cable communications company or by another party, and distributing those programs by wire, cable, microwave or other means, whether the means are owned or leased to persons who subscribe to the service. This definition does not include ... a translator system which receives and rebroadcasts over-the-air signals."

The programming made available by a cable operator may come from satellite or have local origins. A cable operator receives national programming via satellite and packages this programming with local programming, such as PEG access programming, and sells service packages to consumers. Cable subscribers may purchase a basic service package with programming determined by the cable operator, or enhanced service packages with various movie or special interest channels. Cable subscribers also have pay-per-view opportunities, which are commonly used with sporting events.

The programming aggregated at the "head end" of the cable operator is distributed to subscribers via a "tree and branch" system. The programming signals are carried from the head end of the cable operator to neighborhood pedestals over fiber optic or coaxial cable. The pedestals are the utility boxes located every several hundred feet throughout residential areas, and are generally located next to electric and telephone pedestals. From the pedestal to the subscriber's premise, the signal is generally transmitted over coaxial cable. The screening devices, which restrict the programming available to individual subscribers based on the service package selected by the subscriber, are generally located at the pedestal.

A cable company is not subject to common carrier requirements. Thus, it is not required to provide for programming by other parties on its system. PEG access, however, is the exception to this general rule. Minnesota law establishes three categories of cable television systems, each of which has statutory minimum requirements for PEG access, as discussed earlier in this report.

State and federal laws limit the ability of the cable operator to exercise control over content in PEG access programming. Minn. Stat. § 238.11, subd. 2 established content guidelines for PEG access stating that "[n]o cable communications company may prohibit or limit a program or class or type of program presented over a ... channel made available for public access, governmental or educational purposes." 47 USCS § 531 states that, subject to 47 USCS § 544(d), "a cable operator shall not exercise any editorial control over any public, educational, or governmental use of channel capacity provided pursuant to this section."

In addition to the PEG access channel requirements, many cable companies are required to pay a franchise fee to the municipalities in which they provide

service. The Cable Communications Policy Act of 1984 limited the franchise fees that municipalities assess on cable operators to 5 percent of gross revenues. These fees are passed on to the subscribers of the cable service. Furthermore, many municipalities have negotiated for additional compensation in return for granting the cable franchise. This compensation may be in the form of equipment, facilities and personnel to enable PEG programming, cable facilities extended to municipal buildings, private networks, scholarship funds, rent subsidies and free cable service.

OPEN VIDEO SYSTEMS

The Telecommunications Act of 1996 permits telephone companies to engage in video programming within their own telephone service areas as open video systems. The regulations that apply to open video systems are to be established in a rulemaking to be conducted by the FCC. Although all of the terms and conditions for the operation of an open video system are not yet known, the Act identifies some of the requirements of an open video system. One such requirement is that the operator of an open video system must serve as a common carrier. If demand exceeds the channel capacity of the open video system, the operator of an open video system and its affiliates are prohibited from selecting the video programming on more than one-third of the activated channel capacity. Further, the Act appears to prohibit the operator of an open video system from discriminating among video programming providers.

An open video system and a cable communications system are likely to provide some of the same types of video services. Programming and services will differ since the cable company does its own programming and is not subject to common carrier requirements. A cable system may also have different programming than an open video system, due to PEG access requirements. Under federal law, both the cable system and the open video system may be subject to the payment of franchise fees based on gross revenues. The rate at which such fees are imposed on an open video system are not to exceed the rate at which such fees are imposed on any cable operator transmitting video programming in the franchise area.

The Telecommunications Act of 1996 requires the FCC to complete all actions necessary to prescribe regulations on open video systems by July 8, 1996. Thus, not all of the terms and conditions for open video systems have been prescribed. Since the FCC could establish PEG access requirements for open video systems in its rulemaking, any action by the states with respect to PEG access requirements for open video systems could be preempted by federal regulations. The specific requirements on these systems will be clearer after the FCC completes its rulemaking in this matter.

SATELLITE SYSTEMS

"Direct-to-home satellite service" is defined in the Telecommunications Act of 1996 as the distribution or broadcasting of programming or services by satellite directly to the subscriber's premises without the use of ground receiving or distribution equipment, except at the subscriber's premises or in the initial uplink process to the satellite. These programs are transmitted from an earth station via microwave radio signals to a satellite circling the earth in a synchronous orbit around the equator at a height of 22,300 miles. A transponder in the satellite receives the signal, amplifies it, changes the carrier frequency, and retransmits the signal back to earth. These signals can be received throughout the contiguous 48 states. These satellites operate at microwave frequencies in the C-band (4 GHz-6 GHz) and K-band (10.9 GHz to 36 GHz). In most cases, the signal returned to earth by the satellite is received by an antenna or "dish" on the subscriber's premises. Some dishes are 18 inches to 36 inches in diameter and focus on a single satellite operating in the K-band. Other dishes are several feet in diameter, and may be repositioned to pick up different satellites operating in the C-band. In the latitude range of Minnesota, it is necessary that there be a clear unobstructed view of the southern sky from the receiving dish at an angle of around 40° up from the horizon and from about 45° east to about 45° west of straight south.

Providers of satellite programming encode or "scramble" their transmitted signals which in turn must be decoded or "descrambled" in a unit at the subscriber's television set. This is done in order to prevent piracy of programming. There are, however, a number of programs available free of charge on the C-band satellites.

Most of the news, education and entertainment programming that is available on cable television is also available via satellites. The key programming difference between cable and satellite service is that cable service is technically able to accommodate local programming. With satellite systems, the broadcast coverage for most transponder slots is the entire United States, so the programming reflects a wide area of geographic coverage. Therefore, direct-to-home satellite service is technically inconsistent with the provision of PEG access channels. With respect to wireless cable service, the signal is retransmitted locally. Therefore, the technological capability there may provide local programming through wireless cable service may potentially exist at some point in the future. However, the Department is unaware of any cases where a wireless cable operator is currently being required to deliver PEG access programming.

One factor that affects the competitiveness of satellite services with respect to cable television is that satellite services generally require a significant up-front investment in the range of $700 to several thousand dollars for the receiving dish and associated equipment. This is a significant deterrent to customers who can receive most of the same news, education and entertainment programming by subscribing to cable television service which usually has a very nominal installation fee. There is at least one satellite provider, which is a consortium of cable television

providers, that rents the receiving dish and associated equipment to subscribers. This eliminates the requirement of a significant up-front investment for customers desiring satellite service. This provider has an installation charge of up to $200, in addition to the monthly subscription charges which are required for most satellite and cable television programming. The satellite service provider which retransmits from the IDS building also rents the antenna and the necessary equipment to subscribers, and has an installation charge of $50.

The Telecommunications Act of 1996 states that the FCC has exclusive jurisdiction to regulate the provision of direct-to-home satellite services. Therefore, the states may be preempted from establishing requirements on direct-to-home satellite services. Since the FCC has not established rules on franchise fees, it appears that states do not currently have the authority to permit municipalities to assess a franchise fee on direct-to-home satellite services. Further, since the historical concept of a franchise fee is based on the use of public property for private gain, and since the electromagnetic spectrum is not considered to be the property of any municipality, it would appear that a municipality has no basis to assess a franchise fee on either satellite or wireless cable services.

WIRELESS CABLE SERVICES

Wireless cable involves beaming programming from satellites to receiving/transmitting stations. These receiving/transmitting stations are located on hilltops and tall buildings. The signal is then converted to a microwave frequency and broadcast in the 2.5 to 2.7 GHz band to customer locations at distances of up to 40 miles away. At the customer's location, the signal is received by a special rooftop antenna shaped like a barbecue grill, which is installed within a direct line of sight of the transmission tower. The signal travels via cable to a set-top decoder box to be descrambled, thereby transforming the microwave signals for display on a conventional television set. The signal is scrambled to prevent piracy. The cost to hook up each wireless cable subscriber is approximately $500. Existing services from Cross Country and CAI Wireless cost about $20 per month for 30 channels, including antenna rental. "Today, 170 wireless cable systems provide service to roughly 700,000 subscribers in the U.S., according to the Wireless Cable Association. Another 2.8 million receive the service outside the U.S. Wireless Cable operators serve approximately 1 percent of the households in the United States.

Wireless cable operators broadcast cable programming to subscribers using up to 33 microwave channels (i.e., 2 GHz) for video distribution in each market. The channels include the Instructional Television Fixed Service (ITFS), Multipoint Distribution Service (MDS), Multichannel Multipoint Distribution Service (MMDS), and Operational Fixed Service (OFS).

Another type of wireless cable technology is known as local multipoint distribution service (LMDS), which transmits video in the 28-GHz band. Whereas MMDS delivers signals from one antenna, LMDS delivers signals to window

antennas via cell sites that each cover a radius of up to six miles. Some industry experts believe that the use of LMDS technology has been hampered by technological difficulties and by regulatory issues regarding the 28-GHz band.

The wireless cable industry received a boost from the 1992 Cable Act. Under the 1992 Cable Act, wireless cable operators were guaranteed access to cable programming on reasonable terms. Since that time, the wireless cable industry has grown such that there are now seven major publicly traded wireless cable companies with an annual collective growth rate of 175,000 new customers per year. The top ten wireless cable operators as of January 1995 were as follows:

Table 5

Company Name	Number of Actual Subscribers	Estimated number of subscribers that could be served	Penetration %
American Telecasting	121,000	5,500,000	2.2%
ACS Enterprises	66,900	2,380,000	2.8%
People's Choice TV	54,000	1,888,000	2.9%
Cross Country	41,100	390,000	10.5%
Wireless Broadcasting	41,000	842,000	4.9%
CAI Wireless	34,000	3,628,000	0.9%
Cablemaxx	31,500	850,000	3.7%
Heartland Wireless	29,000	1,151,000	2.5%
Preferred Ent.	23,400	2,200,000	1.1%
Omnivision	17,000	117,000	14.5%

One wireless cable system in Minnesota has a receiving/transmitting station on top of the IDS Tower in Minneapolis. The signal is then converted and is broadcast to customer locations within 25 miles of the IDS Tower. Wireless cable service in Minnesota currently utilizes analog technology and offers 16 nationally-oriented channels, including some educational channels, to customers.

The programming on wireless cable service is provided in a manner that more closely resembles satellite transmission services than cable television services. The analog technology used in providing wireless cable service also limits the channel capacity and level of variety that can be offered in programming. There is no federal requirement for the carriage of PEG channels by wireless cable operators and it appears that federal laws governing wireless cable services are preemptive. The Department is aware of no cases where wireless cable has been required to deliver PEG access programming. The Department believes that there are legal and technological barriers to the establishment of state-level PEG access requirements for wireless cable operators.

RECOMMENDATIONS FOR A STATE POLICY REGARDING FRANCHISE FEES AND RELATED COMPENSATION

Many municipalities consider franchise fees to be an important source of revenue. Since it is termed a franchise "fee," it would seem the original intent was to generate revenue to recover costs associated with PEG access, the administration of the franchise, as well as costs associated with the administration of rights-of-way, street repair, etc. Although franchise fee revenues may have identified purposes, there appears to have been little effort to tie the franchise fees received with such purposes. In most communities, local governments believe it is proper for franchise fee revenues to go into the general fund rather than be earmarked for a designated purpose. When expenditures become necessary in the future, such as for street repair, the money comes out of the general fund. But unless municipalities have an effective accounting system in place to track revenue and ensure fees are directly used for service-related expenditures, a strong case can be made to include revenue generated by this levy in annual "truth in taxation" statements.

Cable companies, electric utilities, natural gas utilities and, in many cases, the consumers who ultimately pay these franchise fees would like to see them subject to reasonable limits or, in some cases, phased out. From a market standpoint, the franchise fees and related compensation are anti-competitive when one provider is required to pay them while others are not subject to such fees. Further, it may be considered unfair for service consumers to contribute more to the general fund of a municipality than persons who do not use the service.

Thus, there are very divergent views on the application and proper amount of franchise fees imposed by municipalities. Since it is ultimately the residents and businesses within a municipality that support the municipality through taxes, including an indirect tax through franchise fees, the primary focus of a state policy on franchise fees and related compensation should be based upon the best interest of the residents and business users.

THE PURPOSE FOR WHICH SUCH FEES MAY BE ASSESSED AND PAID

Franchise fee revenue is generated by users of the services of the franchised companies. Users of a utility or cable service may be supporting the general costs of the municipality in addition to paying the cost for the administration of the franchise. Residents and businesses within the municipality who do not subscribe to the service do not support the municipality through the payment of franchise fees. Yet, users of franchised services and those that do not use franchised services generally receive the same benefits from the municipality. An exception may be that franchise fees or other compensation to enable PEG access benefits only those citizens who subscribe to cable service. Thus, with the exception of PEG access, franchise fee revenue and other compensation beyond the administration and other costs associated with the franchise is a form of tax assessed on users of these services.

Other forms of taxes are assessed on different classes of taxpayers. In the case of property tax, most businesses pay higher taxes than residents. Other businesses are tax exempt and, thus, pay less than residents. Yet, as with franchise fees, the amount of taxes paid may have little relationship to the services, programs and other benefits that are provided by the municipality to a class of taxpayers. Municipalities must generate sufficient revenue to fund municipal operations while attempting to be fair to all interest groups.

Any fees imposed on a utility or cable communications company, whether in the form of a franchise fee, permit fee or another type of fee, should attempt to cover the cost that the company places on the system. Thus, the costs associated with rights-of-way, street repairs, etc. should be recovered from the subscribes of the services that cause these costs. If revenues are generated beyond the cost incurred by the municipality, care must be taken to ensure that providers of equivalent services are treated fairly. Since alternative providers of similar services may not be subject to franchise fees, municipalities that assess franchise fees beyond the costs imposed on the system would need to plan a transition to an alternative source of revenue or reduce their revenue requirement.

PEG access policies must also be established to ensure that providers and purchasers of equivalent services are treated fairly. Since satellite services do not lend themselves to local programming, the only viable providers of PEG access at this time appear to be the incumbent cable company, a new entrant in the provision of cable, and possibly a telephone company with an open video system. Although the responses to the survey indicate that PEG access would not exist in the absence of franchise fees, there is some benefit to the cable company from offering PEG access. Some citizens might not subscribe to cable if PEG programming was not included. Also, the availability of PEG programming may cause a subscriber to choose cable rather than an alternative to make use of the service.

The Legislature has previously determined that PEG access is a justifiable purpose for which franchise fees may be assessed and paid.[6] Since the viewership of PEG access is not sufficient on its own to ensure its availability in the absence of a subsidy, requiring both the cable company and a video dialtone provider to duplicate equipment and facilities would divide the viewership, making the service even less viable. A method to avoid duplicating equipment, facilities and various operating expenses when two or more providers of local programming are available would be to establish a single independent entity to perform the functions associated with PEG access similar to the Cable Communications Commissions established under Joint Powers agreements. Each service provider supporting the PEG access operation could be assessed its share of the cost based on the number of subscribers, gross revenue or some other appropriate measure.

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[6] Minnesota Statutes § 238.084, subd. 1.

Recommendation

Franchise fees or franchise-related compensation should be applied only to the portion of new services that are equivalent to existing services. Any fees, whether in the form of a franchise fee, permit fee, or another type of fee, should attempt to cover the cost that the company and consumers of the service impose on the system. Care must be taken to ensure that providers and purchasers of equivalent services are treated fairly. Municipalities that assess franchise fees beyond the costs imposed on the system should plan a transition to an alternative source of revenue or a lower revenue requirement. With the entrance of alternative facilities-based providers of video services, a separate entity should be established (similar to the Cable Communications Commissions established under Joint Powers agreements) to perform the common functions required for PEG access programming. The assessment of fees on service providers may be based on the number of subscribers, gross revenue or some other appropriate measure.

THE AMOUNT OF THE FEES AND THE VALUE OF RELATED COMPENSATION

In markets where there is a single service provider, there may be an assumption that franchise fees can simply be passed on to customers without impacting the competitive dynamics of the market. However, franchise fees have at least two identifiable impacts on the quantity of service purchased by consumers. First, as the price of a good increases, people make efforts to consume less due to income constraints. Second, as the price of a good increases, consumers will search for substitute products. For example, consumers may purchase a gas range rather than an electric range if the rates for electric service are comparably higher than the rates for natural gas service. This impact can be, and often is, greater for discretionary purchases such as cable TV and other video services.

The fees initially paid by a service provider are generally recovered through increased rates to customers. However, if customers are sensitive to the price of the service, a service provider may be unable to pass through the entire amount of the franchise fee to customers. In the case of natural gas and electric service, which are necessities at any price within a relevant range, an increase in price will cause consumers to purchase less service, but will have little impact on the number of customers who subscribe to the service.

The demand for cable service differs from electric and natural gas service for two reasons. First, cable service is not considered by most people to be a necessity. Although the programming is significantly more limited, most consumers have the option of receiving network television without a monthly fee. There are areas, however, that are too remote to receive television broadcasts in the absence of cable or satellite systems. Second, with the exception of pay-per-view, cable television service has a flat monthly fee that is not usage sensitive. Therefore, with cable service, higher prices may cause the number of customers who subscribe to service to decline, but should not significantly affect usage by those who retain cable service.

In markets where there is more than one service provider, the application of franchise fees can play an important role for competitors. If an incumbent pays franchise fees that are proportionately higher than the fees imposed on a competitor, the incumbent will have a cost disadvantage. For example, a franchise fee of five percent on a $25 service charge will lead to a rate difference of $1.25 per month. In this scenario, a competitor may charge lower rates than the incumbent, which will likely result in reduced sales revenue for the incumbent. If the incumbent service provider loses revenue, so will the municipality that assesses franchise fees based on gross revenue. Where permitted by law, a municipality may choose to preserve its franchise fee revenue stream by imposing the same fees on all providers of similar services. Thus, lost revenue from one service provider will be recovered through the payments made by an alternative provider. This is more equitable to the incumbent provider than if alternative providers are not subject to franchise fees. If franchise fees are to be assessed, each provider of an equivalent service should be subject to the same terms.

If an incumbent provider pays franchise fees that are less than those of an alternative provider, the alternative provider will be at a cost disadvantage. In this scenario, an alternative provider may seek out those municipalities that provide the best opportunities to compete with the incumbent service provider. Thus, if the franchise fees are higher for an alternative provider, competition may be hindered in that market.

The amount of payment by a utility or cable communications company to a municipality should cover the cost the company imposes on the municipality whether via franchise fees or permit fees. Franchise-related compensation such as PEG access should be considered in any plan by municipalities to create a fair marketplace to all providers of equivalent services.

Recommendation

All providers of equivalent services should be subject to the same franchise fees and terms by the municipality. Fees should recover the cost imposed on the municipality by the franchisee, including future expenditures such as those due to shortened street lives, etc. Franchise-related compensation should be considered in any plan to create a fair marketplace to all providers of equivalent services.

USES OF FRANCHISE FEE REVENUE AND RELATED COMPENSATION

Recommendation

Franchise fees received by a municipality should only be used for franchise-related activities. Such fees should be separately tracked to ensure that they are not used for other purposes. Since many municipalities currently assess fees beyond that required to support cable-related activities, with the revenues being placed into

the general fund, it is important that franchise fees be reduced to a level which recovers the cost imposed on the municipality. Further, municipalities should not expand their costs to use all of the revenue currently collected. The goal should be to convert this hidden tax into a cost-based fee. The transition to associating costs with the cost causers should emphasize a policy of making the system more cost efficient.

With respect to PEG access, the actual viewers and users of PEG access programming should support its cost. Thus, franchise fees should not be used to support PEG access operations. This would not restrict a municipality from supporting PEG access through an alternative method of funding. In the absence of a subsidy provided by the municipality, if the cost of PEG access programming exceeds its value, and viewers are unwilling to pay for it, PEG access programming should be eliminated in that municipality.

CONTROL OF RIGHTS-OF-WAY

The movement toward competition is going to create tremendous challenges for local governments. Numerous service providers could potentially desire to use the rights-of-way of municipalities to install facilities. Some facilities may duplicate existing facilities already in the rights-of-way. Other facilities may be desired because a different technology is being used to achieve a special purpose. In an effort to stifle competition, existing owners of facilities may not wish to permit competitors to lease excess capacity in an effort to stifle competition. Even if capacity is made available by an incumbent provider, new entrants may feel that facilities could be installed at a lower cost.

In the absence of competition, use of rights-of-way may have been necessary to enable a monopoly service provider to serve customers. Use of rights-of-way to enable customers to have choice of service providers does not have the same significance. However, municipalities must accommodate the reasonable demands of service providers desiring to use rights-of-way to support the current competitive initiatives of the state and federal governments. Yet, when competitors enter the rights-of-way, damage may be done to existing facilities; streets will need to be repaired and replaced more frequently; and citizens of the municipality will be burdened by detours and road construction. Thus, there is a need for a state policy on the use of rights-of-way to promote competition while balancing the interests of the service providers and the citizens of the municipality.

The authority to manage local rights-of-way must remain with local governments. When a service provider desires to place a facility within the rights-of-way, the municipality should be able to require use of a common carrier facility with appropriate compensation if such a facility is available.[7] Although the municipality may not know where facilities currently exist, the utilities and cable

[7] Facilities of a cable communications company are not currently regulated as common carrier facilities.

communications companies should know where they have facilities and excess capacity. When a service provider is initially required to use a common carrier facility, a service provider desiring to use the municipality's rights-of-way should be given the opportunity to do so when the municipality deems it to be appropriate. This may happen when several entities desire to place facilities, limiting the amount of disruption to citizens.

In requiring the use of common carrier facilities, the common carrier and entity desiring to lease facilities may not agree on the terms of interconnection. If agreement cannot be reached, a complaint should be filed with the Public Utilities Commission. The Department of Public Service will investigate any such complaint and present its findings along with comments from other interested intervenors to the Public Utilities Commission for a determination. This practice would essentially mirror the existing practice for competitors in the provision of local telephone service, as stated in Minn. Stat. § 237.16, subd. 10.

If a company desiring to place facilities believes that it is being treated unfairly by a municipality, it should be able to file a complaint with the Public Utilities Commission. Although a municipality is the appropriate entity to manage its rights-of-way, there must be a procedure available to any municipality, utility or cable communications company to resolve disputes. Further, placing the authority to resolve disputes with the Public Utilities Commission will cause municipalities, utilities and cable companies to be reasonable in negotiating agreements.

Recommendation

The authority to manage local rights-of-way must remain with local governments. When a service provider desires to place a facility within the rights-of-way, and a common carrier facility with excess capacity is available, the municipality should be able to require use of that facility with appropriate compensation to the owner. If agreement cannot be reached on the terms of interconnection, a complaint should be filed with the Public Utilities Commission. If a company desiring to place facilities believes that it is being treated unfairly by a municipality, it should be able to file a complaint with the Public Utilities Commission.

CONCLUSION

The four technologies currently capable of delivering subscription video services are standard cable television, open video systems, wireless cable and direct broadcast satellite. Only one of these -- standard cable television -- is both subject to a franchise fee on all gross revenues and is also a technology which is fully compatible with local PEG access requirements.

It appears that open video systems may be subject to franchise fees on gross revenues from the portion of service which is comparable to cable television service. The compatibility of open video systems in providing local PEG access remains a question. Both issues must be resolved in the FCC rulemaking required by the Telecommunications Act of 1996.

Municipalities are specifically barred by the federal government from collecting franchise fees on direct broadcast satellite and wireless cable services. Both are also exempt from and, to a large degree, technically incompatible with providing local PEG access.

Given the differing requirements affecting the technologies which are or will be competing to provide video subscription services, DPS recommends that the state and municipalities proceed with a high degree of caution. Prudent franchise fees aimed at covering right-of-way and PEG access related costs are one matter. Viewing franchise fees as a local "cash cow" and expanding PEG access service beyond demonstrable need or use is another, especially since these apply to only one technology, possibly a portion of another. If government fees and requirements increase consumers' subscription costs for certain services and technologies, they will be at a disadvantage in a competitive market. If the imbalance becomes too great and those services/technologies fail in the competitive arena, municipalities stand to lose both the franchise fee revenue and PEG access they now receive.

	Number of Survey Questionnaire	
	Recipients	Respondents
Municipalities	854	372
Investor-owned natural gas & electric utilities*	12	5
Local exchange telephone companies	103	68
Telecommunications carriers	146	8
AOS providers	21	1
Cable Communications Commissions, Administrators and Providers	54	28
Miscellaneous**	--	3
TOTALS	**1,1901**	**485**

* The number of gas and electric responses in the second paragraph on page 2 in the text is larger than the number of investor owned natural gas and electric companies because many municipal gas and electric companies responded to the questionnaire sent to their respective municipalities.

** There were three responses from organizations that did not receive a questionnaire directly from the Department of Public Service.

ARLINGTON-GAYLORD-GIBBON-WINTHROP CABLE COMMISSION
- Arlington
- Gibbon
- Gaylord
- Winthrop

BURNSVILLE-EAGAN CABLE COMMISSION
- Burnsville
- Eagan

CENTRAL ST. CROIX VALLEY CABLE COMMUNICATIONS COMMISSION
- Bayport
- Baytown Township
- Oak Park Heights
- Stillwater
- Stillwater Township

GREATER GRAND RAPIDS AREA CABLE COMMISSION
- Cohasset
- Grand Rapids
- Grand Rapids Township
- Harris Township
- LaPrairie

LAKE MINNETONKA COMMUNICATIONS COMMISSION
- Deephaven
- Excelsior
- Greenwood
- Long Lake
- Medina
- Minnetonka Beach
- Minnetrista
- Orono
- St. Bonifacius
- Shorewood
- Spring Park
- Tonka Bay
- Victoria
- Woodland

NORTH CENTRAL SUBURBAN CABLE COMMUNICATIONS COMMISSION

Blaine
Centerville
Circle Pines
Coon Rapids
Ham Lake
Lexington
Lino Lakes
Spring Lake Park

NORTH SUBURBAN CABLE COMMISSION

Arden Hills
Falcon Heights
Lauderdale
Little Canada
Mounds View
New Brighton
North Oaks
Shoreview
St. Anthony
Roseville

NORTHWEST SUBURBS CABLE COMMUNICATIONS COMMISSION

Brooklyn Center
Brooklyn Park
Crystal
Golden Valley
Maple Grove
New Hope
Osseo
Plymouth
Robbinsdale

QUAD CITY CABLE COMMUNICATIONS COMMISSION

Anoka
Andover
Champlin
Ramsey

RAMSEY-WASHINGTON SUBURBAN CABLE COMMUNICATIONS COMMISSION

Birchwood Village
Dellwood
Grant Township
Lake Elmo
Mahtomedi
Maplewood

North St. Paul
Oakdale
Vadnais Heights
White Bear Lake
White Bear Township
Willernie

SHERBURNE-WRIGHT CABLE 4

Buffalo
Cokato
Dassel
Delano
Elk River
Maple Lake
Rockford

SOUTH WASHINGTON COUNTY CABLE COMMUNICATIONS COMMISSION

Cottage Grove
Denmark Township
Grey Cloud Island Township
Newport
St. Paul Park
Woodbury